



# Comprehensive Annual Financial Report

*For the fiscal year ended June 30, 2003*



State of West Virginia  
Public Employees Insurance Agency

*(an enterprise fund of the primary government of West Virginia)*

**State of West Virginia**  
**Public Employees Insurance Agency**  
*(an enterprise fund of the primary Government of West Virginia)*

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Bob Wise, Governor

**Comprehensive Annual  
Financial Report**

For the fiscal year ended June 30, 2003

Bob Wise, Governor  
State of West Virginia

Tom Susman, Acting Cabinet Secretary  
West Virginia Department of Administration

Tom Susman, Director  
West Virginia Public Employees Insurance Agency

*Prepared by:*  
Jason A. Haught, CPA  
Chief Financial Officer  
West Virginia Public Employees Insurance Agency

# State of West Virginia

## Public Employees Insurance Agency

### Comprehensive Annual Financial Report

*For the fiscal year ended June 30, 2003*

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# Introductory Section

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These are exciting times for education in West Virginia. ACT scores of our students continue to improve, and the number of board-certified teachers has increased by 57% in two years. Governor Bob Wise funded the PROMISE Scholarship Program in 2001, awarding \$10.1 million in scholarships to nearly 3,500 students in West Virginia its first year and keeping more students in West Virginia. In fact, the percentage of students going-out-of-state is at its lowest point in the last five years.

Bob Wise  
Governor



Tom Susman  
Director

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December 29, 2003

The Honorable Bob Wise, Governor  
State of West Virginia

Mr. Tom Susman, Acting Cabinet Secretary  
West Virginia Department of Administration

Mr. Tom Susman, Director  
West Virginia Public Employees Insurance Agency

Gentlemen:

It is a privilege to submit to you the Comprehensive Annual Financial Report of the West Virginia Public Employees Insurance Agency (PEIA) for the fiscal year ended June 30, 2003. This report was prepared by the office of the PEIA Chief Financial Officer. Responsibility for both the accuracy of the data presented and the completeness and fairness of the presentation, including all disclosures, rests with the management of PEIA. To the best of our knowledge, the data is accurate in all material respects and is reported in a manner designed to present fairly the financial position and results of operations of the various funds, account groups and component units of the State. All disclosures necessary to enable the reader to gain an understanding of PEIA's financial activities have been included.

The Comprehensive Annual Financial Report is presented in three sections: introductory, financial and statistical. This introductory section contains this transmittal letter, a list of the principal officials of PEIA and PEIA's organizational chart. The financial section includes the financial statements and auditor's opinion, as well as certain required supplementary information as described in more detail in the table of contents. The statistical section includes selected financial, economic and demographic data for PEIA.

PEIA was established under the Public Employees Insurance Act of 1971, to provide hospital, surgical, group major medical, prescription drug, group life, and accidental death and dismemberment insurance coverage to eligible employees; and to establish and promulgate rules for the administration of these plans. Benefits are made available to all active and retired employees of the State of West Virginia and various related State agencies and local governments. Participants may elect health insurance coverage through a fully self-insured preferred provider benefit plan (PPB) or through external managed care organizations (MCO). Additionally, all participants may elect to purchase additional life insurance under the optional life insurance policy.

## 2003 Comprehensive Annual Financial Report

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As noted in previous years, PEIA is required to adjust the State employer and State employee aggregate cost sharing percentages. These adjustments must occur in fiscal years 2002 through 2006 with the required ratio established for fiscal year 2007. The adjustments will result in a change in the plan's contribution level of State employers and State employees from the original 90% from State employers and 10% from the State employees, to 80% from employers and 20% from employees. The following chart depicts an updated percentage of contribution levels due to various factors such as enrollment fluctuations and plan migration.

<b>Employer/Employee Contribution Increases</b> <i>(in thousands)</i>					
	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006
State Employer	N/A	N/A	42,000	8,000	57,000
State Employee	N/A	N/A	14,800	0	21,200
Total	N/A	N/A	56,700	8,000	64,200
State Employer Share	<b>86%</b>	<b>83%</b>	<b>82%</b>	<b>82%</b>	<b>81%</b>
State Employee Share	<b>14%</b>	<b>17%</b>	<b>18%</b>	<b>18%</b>	<b>19%</b>

The PEIA Finance Board is required to develop five-year financial plans each fall that begin with the next fiscal year commencing in July. The financial plan must incorporate a mandated reserve fund equal to 10% of total forecast plan expenses for that fiscal year. The fiscal year 2003 year-end PEIA reserve (net assets) did meet the mandated 10% reserve requirement. The year-end reserve was 16% of total plan costs. The current financial plan forecasts PEIA meeting the 10% reserve requirement for fiscal years 2004 through 2008.

PEIA is reported as an enterprise fund in the State of West Virginia's Comprehensive Annual Financial Report. After applying the criteria set forth in generally accepted accounting principles, PEIA management has determined there are no organizations that should be considered component units of PEIA.

### OUTLOOK FOR THE FUTURE

Fiscal year 2003 entailed favorable claims cost trends relative to the previous two fiscal periods. Due to these favorable trends, PEIA completed fiscal year 2003 with a change in net assets of \$33.9 million. The current financial plan includes the following trend assumptions for fiscal year 2004:

Claim Type	FY 2004 Trend Assumptions
Non-Medicare – Medical	10.0%
Non-Medicare – Drugs	22.5%
Medicare – Medical	6.5%
Medicare – Drugs	20.5%

Even with the above trend assumptions, the fiscal year 2004 premium increases, as currently projected, provide revenues sufficient to produce a \$40.3 million change in net assets for fiscal year 2004. If this is achieved, the resulting plan reserve would approximate \$116 million. Consequently, the FY 2005 financial plan did not include an increase for PEIA's largest demographic, the State Fund employees. However, during the financial plan hearings, PEIA advised employees that this is a temporary stay on premium increases and subsequent increases will be required.

This is evident with the new financial plan. With only a modest state employer increase of \$8 million, a \$5 million increase for our smallest risk pool and the trends listed below, the change in net assets is forecasted to be (\$15.2) million for FY 2005.

Claim Type	FY 2005 Trend Assumptions
Non-Medicare – Medical	10.5%
Non-Medicare – Drugs	23.0%
Medicare – Medical	7.0%
Medicare – Drugs	21.0%

In today's healthcare insurance industry environment, minimal premium increases do not offset current trends.

Although current results are favorable, medical and drug costs continue to increase at an unparalleled pace. With PEIA's aging demographic, the plan must continue to explore various methodologies to provide healthcare to our policyholders at an affordable premium. As the fiscal results show in this report, PEIA was able to mitigate the effects of rising costs in FY 2003. This was accomplished by the major initiatives outlined in last years report such as the Medicaid transfer and the multi-state drug-purchasing plan RxIS. PEIA must continue these initiatives and explore others in the future.

### MAJOR INITIATIVES

One of fiscal year 2003's major initiatives dealt with a transfer of funds that PEIA is normally the recipient of to instead be transferred to the West Virginia Bureau for Medical Services – Medicaid Program (Medicaid). This would allow Medicaid to receive federal matching on the revenue, increase hospital reimbursement, and allow PEIA to lower its hospital reimbursement. Medicaid received approval from the Center for Medicare and Medicaid Services and PEIA successfully implemented the Medicaid transfer initiative retroactively effective November 2002.

This initiative saved PEIA approximately \$11.5 million in reduced inpatient hospital claims for fiscal year 2003. The West Virginia Legislature approved the transfer for 3 fiscal years. PEIA will seek to have this transfer extended due to its success thus far. Additionally, all interested parties, including the WV Hospital Association will continue to monitor its overall affect on WV hospitals.

Also one of last years major initiatives was PEIA's development of a multi-state drug purchasing program known as RxIS. This drug purchasing agreement provided PEIA an 11% drug trend for fiscal year 2003. This is 12 percentage points below the 23% trend projected for fiscal year 2003. Granted, this is a one-time trend reduction, but the contract resulted in savings for fiscal year 2003. The most notable saving from the RxIS contract was due to PEIA's increase in manufacturer's formulary rebates. PEIA saw an approximate 200% increase in rebates. PEIA's rebates represented approximately 11% of its drug claim spend in fiscal year 2003. PEIA's current initiative regarding RxIS is to continue diligent enforcement of this contract to ensure future savings.

PEIA is currently exploring an innovative methodology for health care utilization management known as care coordination. Currently, PEIA identifies case management policyholders after certain procedures occur. This can result in thousands of dollars spent prior to utilization management intervention. The new methodology will attempt to identify case management candidates with chronic and potentially expensive disease states before their health deteriorates and expensive treatment is necessary. Using claims information, PEIA will flag certain claim codes that are commonly identified with chronic disease states. Once identified, candidates will be contacted for potential case management.

Another program currently in the implementation stage is a pilot project for diabetic patients in six counties. The pilot project will attempt to mirror the well-known Asheville, NC diabetes program. In essence, diabetic patients will obtain discounts to diabetes related health care services and prescription drugs if they participate in monthly educational sessions with their community pharmacists. PEIA anticipates this program will significantly increase the overall health of our diabetic members and lower plan costs. If successful, the pilot program will be extended to PEIA's entire enrollment.

PEIA is in its third year of a tobacco user premium differential. Premiums for tobacco users is now \$15 more for single coverage and \$30 more for all others per month. PEIA anticipates holding the differential for fiscal year 2005 at its current level.

The funding of retirees' health insurance is a continuing issue with PEIA and the State of West Virginia. In fiscal year 2003, the retirees' claims subsidy was \$79 million, 65% of the retiree plan's costs. The current finance plan forecast the subsidy reaching \$184 million by fiscal year 2008.

### **FINANCIAL HIGHLIGHTS**

The financial statements of PEIA have been prepared on an accrual basis in conformity with generally accepted accounting principles for governmental entities as prescribed or permitted by the Governmental Accounting Standards Board (GASB).

### **Internal control and budgetary control**

PEIA's management is responsible for establishing and maintaining internal controls designed to ensure that the assets of PEIA are protected from loss, theft or misuse and to provide that financial statements are prepared in conformity with generally accepted



accounting principles (GAAP). Internal controls are designed to provide reasonable assurance that these objectives are met. The concept of reasonable assurance recognizes that the cost to administer the control should not exceed the benefits derived from the control.

An annual budget is prepared each fiscal year to be used by management for planning and evaluating performance.

### Financial performance and forecasts

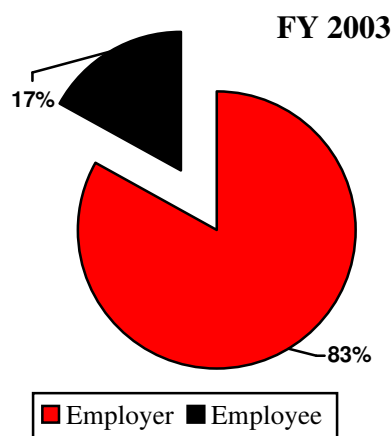
The PEIA had a change in net assets for fiscal year 2003 of \$33,932,555 resulting in an end of year net asset amount of \$76,171,461. The plan had significant increases in premium revenues and claims expense. For further details regarding PEIA's financial condition, please see the Management's Discussion and Analysis section in the financial section beginning on page 13 that incorporates a narrative introduction, overview and analysis of the financial statements.

The current plan design and funding mechanism under the baseline projection model forecasts the following results over the next five years:

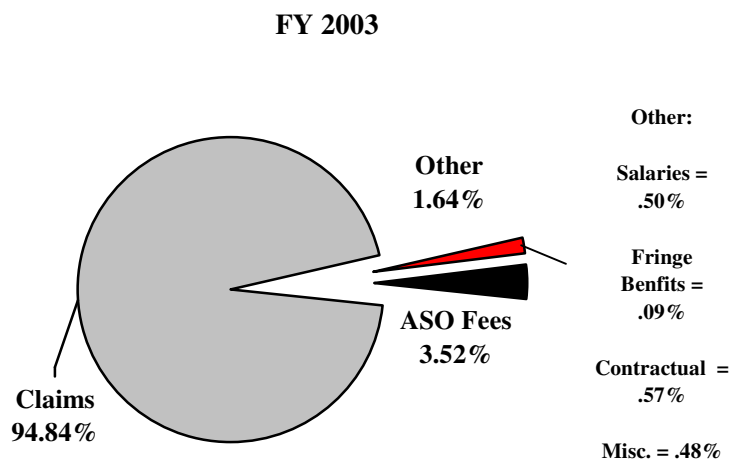
FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
\$40,257,957	(\$15,176,420)	(\$12,272,320)	\$8,607,052	\$16,358,205

### General government functions

The primary function of PEIA is paying insurance claims for its beneficiaries which are financed through employer and employee contributions as illustrated below:



Administrative expenses include payments to third party administrators and the wages and benefits of PEIA employees.



### Proprietary operations

As previously noted, PEIA is reported as an enterprise fund in the State of West Virginia's Comprehensive Annual Financial Report. It is PEIA's intent to cover operating costs through user charges in the form of insurance premiums to employers and employees who participate in the plan.

### Cash management

Cash and cash equivalents are managed by the West Virginia Investment Management Board. In addition, PEIA has funds on deposit with a local financial institution for payment of claims processed by PEIA's third party administrators. Cash in these accounts are the assets of PEIA until such time as claims are paid.

### Risk management

PEIA was established to provide the following employee benefits to the State of West Virginia employees and their dependents: hospital, surgical, group major medical, basic group life, accidental death, and prescription drug insurance coverage.

### OTHER

### Independent audit

PEIA is required by the Financial Accounting and Reporting Section of the Department of Administration to have an annual independent audit. The firm of Ernst & Young, LLP was

selected to perform the audit for fiscal year ended June 30, 2003. Their report is included in the financial section of this report.

### **Awards**

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to West Virginia Public Employees Insurance Agency for its comprehensive annual financial report for the fiscal year ended June 30, 2002. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

### **Acknowledgments**

Special thanks are extended to Governor Bob Wise, for his support in stressing the importance of fiscal responsibility and financial reporting. Acknowledgement is also given to the Legislature and its leadership, whose continued support will promote the future success and stability of the program. Finally, this report would not have been possible without the dedication and effort of PEIA's Director, Tom Susman. Respectfully, we submit the Comprehensive Annual Financial Report for the West Virginia Public Employees Insurance Agency for the year ended June 30, 2003.

Sincerely,

A handwritten signature in black ink, appearing to read "J.A. Haught".

Jason A. Haught, CPA  
Chief Financial Officer



### **Principal Officials**

Bob Wise, Governor  
*State of West Virginia*

Tom Susman, Acting Cabinet Secretary  
*West Virginia Department of Administration*

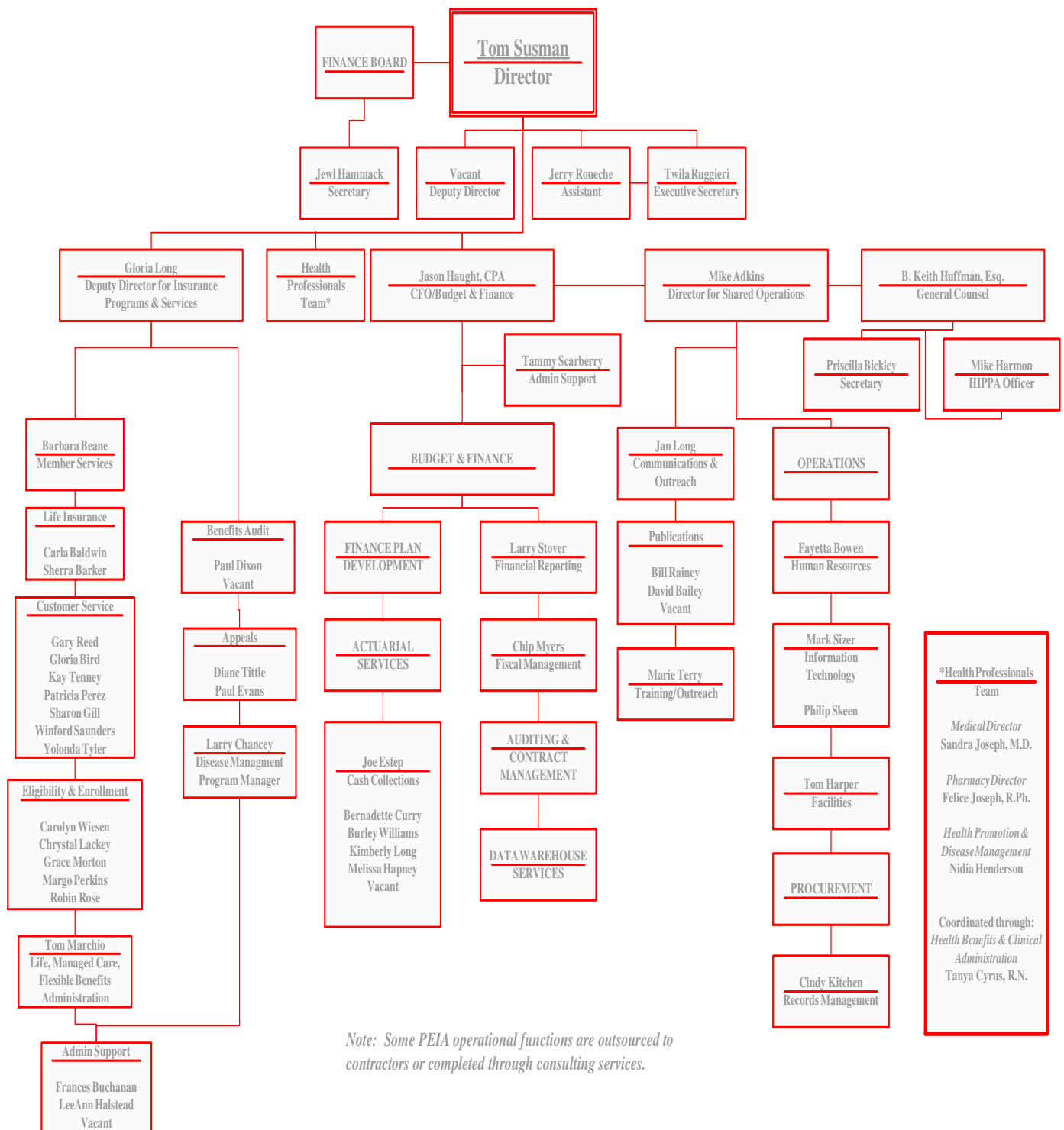
### **Finance Board**

Tom Susman, Chairman  
Joseph Badgley, Member  
John D. Culler, Member  
Elaine Harris, Member  
John Ruddick, Member  
James Schneider, Member  
Denise White, CPA, Member

### **Executive Staff**

Tom Susman, Director  
Jason A. Haught, CPA, Chief Financial Officer

## 2003 Comprehensive Annual Financial Report



*Note: Some PEIA operational functions are outsourced to contractors or completed through consulting services.*

# Certificate of Achievement for Excellence in Financial Reporting

Presented to

West Virginia  
Public Employees  
Insurance Agency

For its Comprehensive Annual  
Financial Report  
for the Fiscal Year Ended  
June 30, 2002

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



President

Executive Director

# Financial Section

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Governor Wise championed legislation to ensure the accessibility, affordability and stability of the health care system in West Virginia. He signed a medical liability reform bill to make West Virginia a state that has economic incentives for doctors to stay in West Virginia, start practices and raise families.

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## Report of Independent Auditors

Board of Directors  
West Virginia Public Employees Insurance Agency

We have audited the accompanying statement of net assets of the West Virginia Public Employees Insurance Agency (PEIA) as of June 30, 2003, and the related statements of revenues, expenses, and changes in net asset and cash flows for the year then ended. These financial statements are the responsibility of PEIA's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of PEIA for the year ended June 30, 2002, were audited by other auditors whose report dated September 21, 2002, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether these financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 2003 financial statements referred to above present fairly, in all material respects, the financial position of PEIA at June 30, 2003, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States.

In accordance with *Government Auditing Standards*, we have also issued a report as of and for the year ended June 30, 2003, dated September 22, 2003, on our consideration of PEIA's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our fiscal year 2003 audit.

The management discussion and analysis on pages 13 through 17 and the unaudited supplemental schedule of Ten-Year Claims Development Information on page 34 are not a required part of the basic financial statements, but are supplementary information required by GASB. We have applied certain limited procedures to the management discussion and analysis on pages 13 through 17 and the Ten-Year Claims Development Information on page 34, which consisted



principally of inquiries of management regarding the methods of measurement and presentation of supplementary information. However, we did not audit the information and express no opinion on it.

We did not audit the data included in the introductory and statistical sections of this report and, accordingly, we express no opinion on them.

*Ernst & Young LLP*

September 22, 2003

West Virginia Public Employees Insurance Agency

Management's Discussion and Analysis

Year ended June 30, 2003

This section of the annual financial report of the West Virginia Public Employees Insurance Agency (the Plan) presents a discussion and analysis of the financial performance of the Plan for the year ended June 30, 2003. Please read it in conjunction with the basic financial statements, which follow this section.

**OVERVIEW OF THE FINANCIAL STATEMENTS**

The Plan's basic financial statements are prepared in accordance with accounting principles generally accepted in the United States of America for governmental entities and insurance enterprises where applicable. The primary purpose of the Plan is to provide group health and prescription drug insurance for the employees of state agencies, colleges and universities, county school boards and other governmental units as set forth in the West Virginia Public Employees Insurance Act of 1971 as amended. The Plan operates in a manner similar to any other insurance company. The Plan is an enterprise fund of the state of West Virginia and is combined with other similar funds to comprise the enterprise funds of the state of West Virginia. The basic financial statements are presented on the accrual basis of accounting. The three basic financial statements presented within the financial statements are as follows:

*Statement of Net Assets*—This statement presents information reflecting the Plan's assets, liabilities, and net assets. Net assets represent the amount of total assets less total liabilities. The statement of net assets is categorized as to current and noncurrent assets and liabilities. For purposes of the basic financial statements, current assets and liabilities are those assets and liabilities with immediate liquidity or which are collectible or become due within 12 months of the statement date.

*Statement of Revenues, Expenses and Changes in Net Assets*—This statement reflects the Plan's operating revenues and expenses, as well as nonoperating revenues during the operating year. The major source of operating revenues is premium income, while major expense areas include medical and prescription drug claims costs. The change in net assets for an enterprise fund is similar to net profit or loss for any other insurance company.

*Statement of Cash Flows*—The statement of cash flows is presented on the direct method of reporting which reflects cash flows from operating, capital, and investing activities. Cash collections and payments are reflected in this statement to arrive at net increase or decrease in cash for the fiscal year.

## West Virginia Public Employees Insurance Agency

## Management's Discussion and Analysis (continued)

**FINANCIAL HIGHLIGHTS**

The following tables summarize the financial position and the results of operations as of and for the years ended June 30, 2003 and 2002.

	June 30		Increase	
	2003	2002	(Decrease)	Percentage Increase (Decrease)
Cash and cash equivalents	<b>\$ 119,019,129</b>	\$ 91,169,031	\$ 27,850,098	30.5%
Premiums receivable	<b>19,127,688</b>	14,634,547	4,493,141	30.7
Other current assets	<b>6,559,431</b>	4,875,085	1,684,346	34.6
Total current assets	<b>144,706,248</b>	110,678,663	34,027,585	30.7
Cash and cash equivalents: premium stabilization fund	<b>1,350,738</b>	1,698,206	(347,468)	(20.5)
Furniture and equipment, net	<b>114,789</b>	160,731	(45,942)	(28.6)
Total assets	<b>146,171,775</b>	112,537,600	33,634,175	29.9
Claims payable	<b>60,954,556</b>	62,392,297	(1,437,741)	(2.3)
Other current liabilities	<b>9,045,758</b>	7,906,397	1,139,361	14.4
Total current liabilities	<b>70,000,314</b>	70,298,694	(298,380)	(0.4)
Net assets - invested in capital assets	<b>114,789</b>	160,731	(45,942)	(28.6)
Net assets - unrestricted	<b>76,056,672</b>	42,078,175	33,978,497	26.5
Total net assets	<b>\$ 76,171,461</b>	\$ 42,238,906	\$ 33,932,555	80.3%

## West Virginia Public Employees Insurance Agency

## Management's Discussion and Analysis (continued)

	Years ended June 30		Increase	Percentage
	2003	2002	(Decrease)	(Decrease)
Net premium revenue	\$ 438,072,864	\$ 366,701,388	\$ 71,371,476	19.5%
Administrative fees, net	4,766,910	4,656,388	110,522	2.4
Total operating revenue	442,839,774	371,357,776	71,481,998	19.2
Claims expense	389,312,256	379,258,215	10,054,041	2.7
Administrative service fees and other expense	21,194,674	16,531,616	4,663,058	28.2
Total operating expenses	410,506,930	395,789,831	14,717,099	3.7
Operating income (loss)	32,332,844	(24,432,055)	56,764,899	(232.3)
Net investment income	1,599,711	3,099,867	(1,500,156)	(48.4)
Supplemental appropriations	-	5,800,000	(5,800,000)	(100.0)
Change in net assets	33,932,555	(15,532,188)	49,464,743	(318.5)
Net assets, beginning of year	42,238,906	57,771,094	(15,532,188)	(26.9)
Net assets, end of year	\$ 76,171,461	\$ 42,238,906	\$ 33,932,555	80.3

Net assets at year ended June 30, 2003, have increased by approximately \$34 million in comparison to the previous year-end amount. This increase resulted primarily from the operating income earned during the year.

Cash and cash equivalents, exclusive of the premium stabilization fund, increased by approximately \$28 million during the year primarily due to the current year income less the funding of higher levels of premiums and prescription rebates receivable plus the proceeds of other assets liquidated.

The premium stabilization fund, which represents cash received from optional life insurance dividends collected, decreased by approximately \$.3 million during the year as the result of the use of these funds to reduce optional life insurance premium rates charged to the policyholders.

Claims payable decreased approximately \$1.4 million primarily due to a decrease in hospital reimbursement rates and a somewhat faster claims processing timeframe.



West Virginia Public Employees Insurance Agency

Management's Discussion and Analysis (continued)

Other current liabilities have increased by approximately \$1.1 million due to an increase in non-claims related accounts payable and other liabilities.

The approximate \$71 million increase in net premium revenue was primarily the result of increases in health insurance premium rates, overall increases in health insurance enrollment of approximately 1,100 policyholders less an increase of approximately \$5 million in payments to managed care organizations and life insurance premiums. Other operating revenue reflects the overall increase in enrollment.

Medical and prescription drug claims expense comprises approximately 95% of the Plan's total expenses. Claims expense increased approximately \$10 million or approximately 2.7% over the prior year. Medical claims decreased approximately \$1.7 million or .6% under the previous year and prescription drug claims increased approximately \$11.7 million or 11%. Total trends associated with these increases, after adjustments to exclude the effect of enrollment increases, were -0.5% for medical claims and 11.1% for drug claims. The negative medical trend is primarily the result of State legislation which directed higher reimbursement levels and greater funding for the State's Medicaid program along with a reduction in PEIA reimbursement levels. The current year drug trend is well below the national levels as a result of PEIA's achievement of much larger prescription drug rebates, a deeper usage of generic drugs and a more tightly controlled utilization program.

Administrative service fees and other expenses accounted for 5% of the Plan's total expenses. These costs increased \$4.7 million or 28% above the previous year. Effective with plan year 2003, PEIA structured a new arrangement with its prescription benefit manager which resulted in substantially higher administrative service fees in exchange for the full and undivided prescription rebates earned from the various drug manufacturers. This arrangement was the principal reason for an increase of approximately \$3.5 million in administrative service fees. In addition, PEIA increased its spending on wellness and disease management by approximately \$0.4 million, increased the size of its staff and incurred a higher usage of outside professionals in order to better serve its membership and better control costs.

As previously mentioned, the Plan experienced an increase of approximately \$34 million or 80.3% in total net assets for the year ended June 30, 2003. The premium rates adopted for the year were based on assumptions used in developing the financial plan for the year ended June 30, 2003, which reflected an expected increase in total net assets of approximately \$8.1 million. However, total claims costs for the year totaled \$23 million less than the forecast and resulted in a substantial improvement in operating results.

West Virginia Public Employees Insurance Agency

Management's Discussion and Analysis (continued)

**ECONOMIC CONDITIONS**

After allowing for the contribution to retirees healthcare cost which is included in the active policyholder premium amount, the Plan's average active employee family monthly premium cost is \$632.00 compared to the national average cost of \$733.33. It should be noted that the Plan's monthly premium cost above has not been adjusted to reflect the \$34 million earned during the year that will be used to mitigate future premium increases.

The rate of healthcare inflation has a direct impact on medical costs and the associated premium rates charged by the Plan. For the annual period which ended in the spring of 2003, employer-sponsored health insurance cost rose 13.9% nationally. During the same period the overall inflation rate held to 2.2% and wage gains for non-supervisory workers moved up 3.1%. Such increases in healthcare costs place a substantial burden on all employers as they struggle through these slow economic times.

Due to an anticipated continuance of healthcare inflation, the Plan placed premium rate increases into effect beginning July 1, 2003, which are expected to produce additional revenues of approximately \$68.3 million for the year.

**CAPITAL ASSET AND LONG-TERM DEBT ACTIVITY**

The Plan has minimal capital assets that are not fully depreciated and has no long-term debt.

## West Virginia Public Employees Insurance Agency

## Statements of Net Assets

	June 30	
	2003	2002
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 119,019,129	\$ 91,169,031
Premiums receivable:		
Due from State of West Virginia	3,705,041	3,936,444
Other, less allowance for doubtful accounts of \$881,000 and \$1,000,000, respectively	15,422,647	10,698,103
Accounts receivable:		
Provider refunds, less allowance for doubtful accounts of \$344,000 and \$225,000, respectively	449,261	1,073,811
Prescription rebates	5,377,329	2,441,716
Other	732,841	1,359,558
Total current assets	144,706,248	110,678,663
Noncurrent assets:		
Cash and cash equivalents: premium stabilization fund	1,350,738	1,698,206
Furniture and equipment, net of accumulated depreciation of \$486,556 and \$398,617, respectively	114,789	160,731
Total assets	146,171,775	112,537,600
<b>Liabilities</b>		
Current liabilities:		
Claims payable	60,954,556	62,392,297
Accounts payable	5,658,850	4,482,151
Deferred revenue	2,212,693	2,583,614
Other accrued liabilities	1,174,215	840,632
Total current liabilities	70,000,314	70,298,694
<b>Net assets</b>		
Invested in capital assets, net of related debt	114,789	160,731
Unrestricted	76,056,672	42,078,175
Total net assets	\$ 76,171,461	\$ 42,238,906

See accompanying notes.

## West Virginia Public Employees Insurance Agency

## Statements of Revenues, Expenses, and Changes in Net Assets

	Years ended June 30	
	2003	2002
Operating revenues:		
Premiums	\$ 494,803,110	\$ 418,663,654
Less:		
Payments to managed care organizations	(50,336,032)	(46,818,034)
Life reinsurance premiums	(6,394,214)	(5,144,232)
Net premium revenue	438,072,864	366,701,388
Administrative fees, net of refunds	4,766,910	4,656,388
Total operating revenues	442,839,774	371,357,776
Operating expenses:		
Claims expense, net	389,312,256	379,258,215
Administrative service fees	14,444,565	10,917,542
Other expenses	6,750,109	5,614,074
Total operating expenses	410,506,930	395,789,831
Operating income (loss)	32,332,844	(24,432,055)
Nonoperating revenues:		
Investment income, net of fees	1,599,711	3,099,867
Supplemental appropriations	-	5,800,000
Change in net assets	33,932,555	(15,532,188)
Net assets at beginning of year	42,238,906	57,771,094
Net assets at end of year	\$ 76,171,461	\$ 42,238,906

See accompanying notes.



## West Virginia Public Employees Insurance Agency

## Statements of Cash Flows

	Years ended June 30	
	2003	2002
<b>Cash flows from operating activities</b>		
Cash received from customers	\$ 435,981,532	\$ 364,143,940
Cash received from pharmacy rebates	8,816,011	5,728,208
Cash paid to employees	(1,842,206)	(1,455,287)
Cash paid to suppliers and others	(17,444,413)	(16,615,811)
Cash paid for claims	(399,566,008)	(382,207,300)
Net cash provided by (used in) operating activities	25,944,916	(30,406,250)
<b>Cash flows from noncapital financing activities</b>		
Supplemental appropriations	-	5,800,000
Net cash provided by noncapital financing activities	-	5,800,000
<b>Cash flows from capital and related financing activities</b>		
Cash purchases of furniture and equipment	(41,997)	(33,091)
Net cash used in capital and related financing activities	(41,997)	(33,091)
<b>Cash flows from investing activities</b>		
Cash received from investment earnings (net)	1,599,711	3,099,867
Net cash provided by investing activities	1,599,711	3,099,867
Net increase (decrease) in cash and cash equivalents	27,502,630	(21,539,474)
Cash and cash equivalents at beginning of year	92,867,237	114,406,711
Cash and cash equivalents at end of year	\$ 120,369,867	\$ 92,867,237

## West Virginia Public Employees Insurance Agency

## Statements of Cash Flows (continued)

	Years ended June 30	
	2003	2002
<b>Reconciliation of operating income (loss) to net cash provided by (used in) operating activities</b>		
Operating income (loss)	\$ 32,332,844	\$ (24,432,055)
<b>Adjustments</b>		
Depreciation	87,939	93,891
Decrease (increase) in operating assets:		
Premium receivable	(4,724,544)	(4,023,395)
Due from State of West Virginia	231,403	(2,605,219)
Provider refunds	624,550	944,016
Prescription refunds	(2,935,613)	(109,510)
Other	626,717	(1,359,558)
Increase (decrease) in operating liabilities:		
Claims payable	(1,437,741)	10,021,123
Accounts payable	1,176,699	(3,343,543)
Premium deficiency reserve	-	(7,242,000)
Deferred revenue	(370,921)	1,523,575
Other accrued liabilities	333,583	126,425
Total adjustments	(6,387,928)	(5,974,195)
Net cash provided by (used in) operating activities	<u>\$ 25,944,916</u>	<u>\$ (30,406,250)</u>

See accompanying notes.

West Virginia Public Employees Insurance Agency

Notes to Financial Statements

Years ended June 30, 2003 and 2002

**1. Reporting Entity**

The State of West Virginia Public Employees Insurance Agency (PEIA) was established under the Public Employees Insurance Act of 1971 (Act). PEIA is an agency of the State of West Virginia and, accordingly, is reported as an enterprise fund of the primary government in the State's Comprehensive Annual Financial Report (CAFR).

PEIA provides the following basic employee benefit coverage to all participants: hospital, surgical, group major medical, basic group life, accidental death and prescription drug coverage for active and retired employees of the State of West Virginia (State) and various related State and non-State agencies. Additionally, all participants may elect to purchase additional life insurance under the optional life insurance policy. All premium rates are established based upon projected coverage costs as reviewed and approved by the Finance Board of PEIA. See "Budgetary Requirements" for further discussion of this process. PEIA's enrollment consists of approximately 102,000 health and basic life insurance policyholders, and 14,000 policyholders with life insurance only. PEIA insures approximately 219,000 individuals, including participants and dependents.

The financial statements of the PEIA are intended to present the financial position, and the changes in financial position and cash flows of only that portion of the business-type activities of the State of West Virginia that is attributable to the transactions of the PEIA. They do not purport to, and do not, present fairly the financial position of the State of West Virginia as of June 30, 2003, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

**2. Summary of Significant Accounting Policies**

**Basis of Reporting**

PEIA operates as an insurance enterprise fund. Accordingly, the financial statements of PEIA have been prepared on the accrual basis in conformity with accounting principles generally accepted in the United States of America for governmental entities as prescribed or permitted by the Governmental Accounting Standards Board (GASB). Revenues mainly are derived from premiums earned net of related reinsurance premiums, plus administrative fees billed. Expenses consist primarily of claims, administrative service fees, and various general and administrative costs. In September 1993, GASB issued Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*. As permitted by the Statement, PEIA has elected not to adopt Financial Accounting Standards Board (FASB) statements and interpretations issued after November 30, 1989, unless GASB specifically adopts such FASB statements or interpretations.

West Virginia Public Employees Insurance Agency

Notes to Financial Statements (continued)

**2. Summary of Significant Accounting Policies (continued)**

**Adoption of GASB 34 and Related Statements**

In June 1999, the GASB issued Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*. The GASB has also issued several related statements, including Statement 33, *Accounting and Financial Reporting for Nonexchange Transactions*, Statement 36, *Recipient Reporting for Certain Shared Nonexchange Revenues*, Statement 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus*, and Statement 38, *Certain Financial Statement Note Disclosures*. These statements established financial reporting standards for state and local governments by revising the basic financial statement requirements and also requiring a management's discussion and analysis to introduce the basic financial statements and to provide an analytical overview of the entity's financial activities. PEIA adopted the provisions of these statements beginning with the fiscal year ended June 30, 2002, consistent with the State of West Virginia's adoption period. Because PEIA is an enterprise fund, the adoption of GASB Statement No. 34 and related statements did not have a material effect on reported operations or net assets; however, the adoption of the Statement did result in certain changes in the financial statements, including reporting a statement of net assets as opposed to a balance sheet and reporting net assets as opposed to retained earnings, as well as other differences.

**Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make certain estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from management's estimates.

**Budgetary Requirements**

The Act requires the Finance Board of PEIA to prepare a proposed annual financial plan. The plan must be designed to generate sufficient revenues to meet all expected expenses, including insurance, administrative expenses, and incurred but unreported claims of the PEIA. An independent professional actuary must review the plan and give an opinion stating that the plan may be reasonably expected to generate sufficient revenue to meet estimated insurance claims and administrative expenses. The financial plan must be presented to the governor and the legislature no later than January 1, prior to the beginning of the new plan year.



West Virginia Public Employees Insurance Agency

Notes to Financial Statements (continued)

**2. Summary of Significant Accounting Policies (continued)**

The PEIA Finance Board establishes PEIA premiums based upon its approved annual financial plan. The financial plan projects the anticipated costs of the program for each fiscal year and the premium levels necessary to meet these costs. Any variances between projected and incurred costs are incorporated into subsequent financial plans and subsequent premiums are adjusted accordingly on a prospective basis. Premiums assessed by PEIA are not subject to retroactive adjustment based upon actual costs incurred.

**Cash and Cash Equivalents**

Cash and cash equivalents are short-term investments with original maturities of 90 days or less. Cash and cash equivalents principally consist of amounts on deposit in the State Treasurer's Office (STO) that are pooled funds managed by the West Virginia Investment Management Board (IMB). In addition, PEIA makes interest-earning deposits in certain investment pools maintained by IMB that are available to PEIA with overnight notice. Interest income from these investments is prorated to PEIA at rates specified by IMB based on the balance of PEIA's deposits maintained in relation to the total deposits of all state agencies participating in the pool. Because these assets are held in the IMB investment pools, no other disclosures related to credit or market risk are required. However, market risk exists as the value of the investment pools underlying investment assets may decline because of an increase in interest rates or a decline in stock prices. The carrying value of the deposits reflected in the financial statements approximates fair value and approximates the value of the shares in the external investment pool.

The STO has statutory responsibility for the daily cash management activities of the State's agencies, departments, boards, and commissions. The STO determines which funds to transfer to the IMB for investment in accordance with the West Virginia Code, policies set by the IMB, and provisions of bond indentures and trust agreements when applicable. The IMB is governed by a 13-member Board of Trustees. The Governor, the State Auditor and the State Treasurer are members of the Board and the other members are appointed by the Governor. The Board was formed in 1997 to serve as the Trustee to hold certain public pension funds and insurance funds, as well as to provide prudent fiscal administration, investment, and management of the Consolidated Pension Fund and the State's operating funds.

**Premiums Receivable**

All premiums receivable are reported at their gross premium value due from employers and individual subscribers. The gross value is then reduced by the estimated portion that is expected to be uncollectible based upon management's review of the payment status of the underlying accounts and other economic factors that are deemed necessary in the circumstances.

West Virginia Public Employees Insurance Agency

Notes to Financial Statements (continued)

**2. Summary of Significant Accounting Policies (continued)**

**Accounts Receivable**

Accounts receivable include overpayments made by third-party administrators which are due to PEIA and estimated prescription refunds and rebates which are due PEIA from third-party administrators and other drug companies. The estimated prescription refunds/rebate receivable estimate is based upon estimated prescription claim count and historical average rebate per claim. These receivables have been reduced by the estimated portion that is expected to be uncollectible based upon management's review of the payment status of the underlying accounts and other economic factors that are deemed necessary in the circumstances.

**Furniture and Equipment**

Furniture and equipment with an initial cost of \$1,000 or greater are recorded at cost. PEIA has assigned a useful life of three to five years for the furniture and equipment. Depreciation expense is computed using the straight-line method.

**Claims Payable and Expense**

The liability for unpaid preferred provider benefit (PPB) claims and claims processing costs is based on an actuarial estimate of the ultimate cost of settling such claims incurred as of the balance sheet date (including claims reported and in process of settlement, claims reported but not yet processed for settlement, and claims incurred but not yet reported or processed for settlement). The estimated actuarial liability reflects certain assumptions, which include such factors as enrollment, utilization, inflation, and other societal and economic factors. Adjustments to the estimated actuarial liability for the final settlement of claims will be reflected in the year that the actual results of the settlement of the claims are made and are known. The estimated liability is adjusted annually based on the most current claim incurrence and claim settlement history (see Note 5). Claims relating to participants in Managed Care Organizations (MCOs) as well as claims relating to participants covered under the optional life insurance plan are not considered in the liability as PEIA has no liability for the participants who elect such coverage. Additionally, the estimated liability for unpaid claims and claims processing costs is recorded net of amounts ceded to reinsurers for basic life benefits as management believes these reinsured risks are fully recoverable. However, in the event a reinsurer is unable financially to satisfy an obligation, PEIA is responsible for such liability. Claims expense is reported net of pharmacy rebate income of \$12,029,814 and \$5,713,862 for the years ended June 30, 2003 and 2002, respectively.

West Virginia Public Employees Insurance Agency

Notes to Financial Statements (continued)

**2. Summary of Significant Accounting Policies (continued)**

**Deferred Revenue**

Deferred revenue included premium revenues collected for future contract periods and unexpended grant proceeds. These revenues will be recognized in the operating periods in which they are earned or related eligible grant expenditures are incurred.

**Insurance Programs and Related Premium Revenues**

PEIA offers the following types of coverage to its participants: health coverage through a self-insured preferred provider benefit (PPB) plan, health coverage through external MCOs, and life and accidental death and dismemberment (AD&D) insurance benefits under basic and optional plans. PEIA collects premiums for participants in the PPB plan and uses these premiums in the administration of the plan. Additionally, PEIA has the statutory authority to raise additional revenues in the form of premiums without the need for external (legislative) action.

For participants who elect coverage through MCOs, PEIA collects premiums from employers and remits a capitation fee to an MCO carrier. The capitation fees paid by PEIA to each MCO are in accordance with their respective contracts. Benefits are the responsibility of each MCO carrier. The premiums earned by PEIA have been included in gross premium revenue while the capitation fees submitted to each MCO carrier are reflected as payments to MCOs on the financial statements.

Employees covered through PEIA are eligible to obtain life insurance coverage under basic and optional life insurance plans. Basic life benefits and AD&D benefits of \$10,000 are provided to active State employees under the age of 65 at no cost to the employee. Coverage amounts decrease with age. No AD&D benefits are available to retirees. Basic life benefits are available to retirees with coverage ranging from \$2,500 to \$5,000 depending on age. For these basic life benefits, PEIA collects premiums and submits them to the insurance carrier. PEIA has reinsured 100% of these basic benefits; however, PEIA remains contingently liable in the event the insurer does not honor its obligation. The premiums earned for basic life insurance are reflected in gross premiums and the related amounts ceded to the reinsurer are reflected as life reinsurance premiums on the financial statements.

Active employees may elect to obtain additional optional coverage for both life and AD&D with coverage from \$5,000 to \$500,000 that decreases with age. Active employees may also elect dependent optional life coverage and AD&D at a level up to \$20,000 per spouse and \$10,000 per child. Retirees may obtain optional life insurance coverage from \$5,000 to \$150,000 depending



West Virginia Public Employees Insurance Agency

Notes to Financial Statements (continued)

**2. Summary of Significant Accounting Policies (continued)**

on age; however, optional AD&D insurance is not available to retirees. Retirees may also elect dependent optional life coverage at levels up to \$20,000 for spouse and \$10,000 per child. Amounts collected by PEIA from employees for optional coverage totaled \$16,083,798 and \$13,760,557 during the fiscal years ended June 30, 2003 and 2002, respectively, and were remitted directly to the carrier. In this instance, PEIA functions as an agent and, accordingly, neither these premiums nor the related costs are reflected in the financial statements.

Revenues include an administrative fee that PEIA charges to all participating entities in the plan. The fee is based on the participating entities' number of employees enrolled in the plan.

**Administrative Service Fees**

PEIA contracts with and pays administrative service fees to two third-party administrators. These services include processing of insurance claims, precertification reviews, utilization reviews, and various other duties. The majority of related fees are assessed each month based upon the number of covered participants or claims processed at predetermined rates without regard to the period in which a claim is incurred, processed or settled.

**Supplemental Appropriations**

Supplemental appropriations represent legally authorized appropriations under West Virginia State Code by the West Virginia Legislature.

**Compensated Absences, Including Postretirement Benefits**

Employees fully vest in all earned but unused annual leave and PEIA accrues for obligations that may arise in connection with compensated absences for vacation at the current rate of employee pay. In accordance with State personnel policies, employees vest in any remaining unused sick leave only upon retirement, at which time any unused compensated absence time can be converted into employer paid premiums for postretirement health care coverage through PEIA, or be converted into a greater retirement benefit under the State's Public Employees' Retirement System. The estimated obligation for such benefits, as they relate only to those persons employed directly by PEIA presently or in the past, is recorded as a liability in the accompanying financial statements.



West Virginia Public Employees Insurance Agency

Notes to Financial Statements (continued)

**2. Summary of Significant Accounting Policies (continued)**

**Operating Revenues and Expenses**

Balances classified as operating revenues and expenses are those that comprise PEIA's ongoing operations. Principal operating revenues include health insurance premiums, life insurance premiums and insurance administration fees, less amounts paid to managed care organizations and life insurance reinsurers. Operating expenses include the cost of medical claims, drug claims, claims adjudication, administration and depreciation of capital assets. Other revenues and expenses are classified as nonoperating in the financial statements.

**Net Assets**

As required by GASB 34, PEIA displays net assets in three components, if applicable: invested in capital assets, net of related debt; restricted, and unrestricted.

*Invested in Capital Assets, Net of Related Debt*—This component of net assets consists of capital assets, including restricted capital assets (if any), net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.

*Restricted Net Assets*—Restricted net assets should be reported when constraints placed on the net assets use are either externally imposed (for instance, by creditors, laws or grantors) or imposed by law through constitutional provisions or enabling legislation. Such constraints limit the PEIA's ability to use the resources to pay current liabilities. When both restricted and unrestricted resources are available for use, it is the PEIA's policy to use restricted resources first, then unrestricted resources as needed.

*Unrestricted Net Assets*—Unrestricted net assets consist of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt." In the governmental environment, net assets are often *designated* to indicate that management does not consider them to be available for general operations. These types of constraints on resources are internal and management can remove or modify them. Such internal designations are not reported on the face of the statement of net assets.

West Virginia Code section 5-16-25 requires the Finance Board of PEIA to maintain a reserve of 10% of projected plan costs for general operation purposes and provide future plan stability. In the event the reserve fund exceeds 15% of the actuarial recommended reserve of 20% to 25% of total projected costs, the excess is to be remitted to the Department of Administration. As of June 30, 2003, PEIA has sufficient net assets to comply with this code section. Additionally, there were no excess amounts due to the Department of Administration.

## West Virginia Public Employees Insurance Agency

## Notes to Financial Statements (continued)

**3. Cash and Cash Equivalents**

Following is a summary of PEIA's cash and cash equivalents as of June 30:

	2003	2002
Cash deposited with IMB (cash liquidity pool):		
Premium stabilization fund	\$ 1,350,738	\$ 1,698,206
Other	105,045,697	85,508,693
Total cash deposited with IMB	106,396,435	87,206,899
Cash on deposit with State Treasurers Office	12,460,547	4,822,581
Deposits with outside financial institutions	1,512,885	837,757
	<u>\$ 120,369,867</u>	<u>\$ 92,867,237</u>

PEIA has funds on deposit with a local financial institution to enable the third-party administrators to process claims for PEIA. As of June 30, 2003, the carrying amount of PEIA's bank deposits was \$1,512,885 and the respective bank balances totaled \$8,288,311. Of the total bank balance, \$2,287 was insured through Federal Deposit Insurance Corporation (FDIC). The remaining \$8,286,024 was collateralized with government-sponsored enterprise securities held by the financial institution. These securities are held in the name of the financial institution and not that of PEIA.

The administrators issue claims payments from these funds. Any funds in such accounts are the assets of PEIA until such time as claims payments are made. If the claims checks issued on these accounts exceed the funds currently on deposit, the resulting deficiency is the responsibility of PEIA. Interest is earned by PEIA on the balances maintained in these accounts.

**4. Premium Stabilization Fund**

The premium stabilization fund consists of accumulated dividends and interest on participant optional life insurance policies. This account was established in 1979 for the sole purpose of accumulating optional life insurance policy dividends and defraying future premium increases. Because these amounts are designated internally for this purpose, management does not intend on using these resources for operations. For cash flow purposes, cash and cash equivalents include \$1,350,738 and \$1,698,206 as of June 30, 2003 and 2002, respectively, related to this fund.

## West Virginia Public Employees Insurance Agency

## Notes to Financial Statements (continued)

**5. Unpaid Claims Liabilities**

As discussed in Note 2, PEIA establishes a liability for both reported and unreported insured events, which includes an estimate of future payments of losses. The following represents changes in those aggregate liabilities, excluding the impact of the change in the premium deficiency reserve, for PEIA for the years ended June 30:

	2003	2002
	<i>(In Thousands)</i>	
Claims payable, beginning of year	\$ 62,392	\$ 52,371
Incurred claims expenses:		
Provision for insured events of the current year	393,862	379,582
(Decrease) increase in provision for insured events of prior years	(4,550)	6,918
Total incurred claims expense	389,312	386,500
Payments:		
Claim payments attributable to insured events of:		
Current year	343,939	327,451
Prior years	46,810	49,028
Total payments	390,749	376,479
Claims payable, end of year	\$ 60,955	\$ 62,392

**6. Supplemental Appropriations**

During the year ended June 30, 2002, PEIA received \$5,800,000 from the State Department of Administration, which was made available through supplementary appropriations as directed by the West Virginia Legislature. The Public Employees Insurance Reserve Fund appropriations of \$5,800,000 during the year ended June 30, 2002, are appropriations from a reserve fund established by the Legislature under West Virginia State Code §5A-2-14a. This code section established a "Public Employees Insurance Reserve Fund" funded by statutorily required payments from most state agencies. Appropriations may, at the discretion of the Legislature, be transferred from the Public Employees Insurance Reserve Fund to PEIA. No such appropriations were received by PEIA during the year that ended June 30, 2003.



## West Virginia Public Employees Insurance Agency

## Notes to Financial Statements (continued)

**7. Employee Benefit Plans**

All full-time PEIA employees are eligible to participate in the State of West Virginia Public Employees Retirement System (PERS), a cost-sharing multiple-employer public employee retirement system. Employees who retire at or after age 60 with five or more years of contributory service or who retire at or after age 55 and have completed 25 years of credited service are eligible for retirement benefits as established by State statute. Retirement benefits are payable monthly for life, in the form of a straight-line annuity equal to two percent of the employee's final average salary, multiplied by the number of years of the employee's credited service at the time of retirement. PERS also provides deferred retirement, early retirement, and death and disability benefits and issues an annual report which can be obtained by contacting PERS.

Covered employees are required to contribute 4.5% of their salary to PERS. PEIA is required to contribute 9.5% of covered employees' salaries to PERS. The required employee and employer contribution percentages are determined by actuarial advisement within ranges set by statute. PEIA and employee contributions, both the statutorily required and actual contributions made, for the three years ended June 30 are as follows:

	2003	2002	2001
Employer contributions (9.5%)	\$ 192,351	\$ 137,787	\$ 114,703
Employee contributions (4.5%)	91,114	65,268	54,333
Total contributions	<u>\$ 283,465</u>	<u>\$ 203,055</u>	<u>\$ 169,036</u>

**8. Postemployment Benefits Other Than Pension Benefits**

Upon retirement, an employee may apply unused sick leave or annual leave, or both to reduce their future insurance premiums paid to PEIA or to obtain a greater benefit under PERS. The estimated liability at June 30, 2003 and 2002, for sick leave postretirement benefits approximating \$270,667 and \$221,635, respectively, is included in other accrued liabilities in the statements of net assets. During the years ended June 30, 2003 and 2002, PEIA disbursed \$5,187 and \$6,079, respectively, from the liability balances discussed above to fund health insurance premiums for one and two of its retirees, respectively, who had elected to use their accumulated leave time for health coverage.

West Virginia Public Employees Insurance Agency

Notes to Financial Statements (continued)

**9. Risk Management**

PEIA is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to and illnesses of employees; and natural disasters.

Health insurance coverage for PEIA's employees is available on a contributory basis through PEIA programs. PEIA makes available the following basic employee benefit coverage to all participants: hospital, surgical, group major medical, basic group life, accidental death, and prescription drug coverage for active and retired employees. Additionally, PEIA has obtained coverage for job-related injuries through its participation in the West Virginia Workers' Compensation Fund, a public entity risk pool. Furthermore, PEIA participates in the West Virginia State Board of Risk and Insurance Management, a public entity risk pool, to obtain coverage in the amount of \$1,000,000 per occurrence for general liability and property damage. There have been no settlements that have exceeded this coverage in the last three years.

**10. Litigation**

PEIA is engaged in various legal actions that it deems to be in the ordinary course of business. PEIA believes that it has adequately provided for probable costs of current litigation. As these legal actions are resolved, however, PEIA could realize positive and/or negative impact to its financial performance in the period in which these legal actions are ultimately decided.

PEIA is the defendant in a dispute with its former prescription benefit manager (PBM), which essentially maintains that PEIA owes it approximately \$3 million based upon a shared savings provision in the contract. PEIA is also the plaintiff in a dispute with its former PBM maintaining the PBM did not live up to their contract and owes PEIA damages in an unspecified amount. The ultimate outcome of this matter cannot be determined at the present time. In the opinion of management, after consultation with legal counsel, resolution of this matter is not expected to have a material adverse effect on net assets.

## Required Supplemental Schedule

## West Virginia Public Employees Insurance Agency

## Ten-Year Claims Development Information (Unaudited)

The table below illustrates how PEIA's earned premiums (net of reinsurance) and investment income compare to related costs of loss (net of loss assumed by reinsurers) and other expenses assumed by PEIA as of the end of each of the years presented. The rows of the table are defined as follows: (1) This line shows the total of each fiscal year's earned and ceded premiums, administrative fees, other operating and investment revenues. (2) This line shows each fiscal year's other operating costs of PEIA including overhead and unallocated claims expense not allocable to individual claims. (3) This line shows PEIA's incurred and ceded claims and allocated claims adjustment expense (both paid and accrued) as originally reported at the end of the first year in which the event that triggered coverage occurred (called accident year). (4) These lines show the cumulative amounts paid as of the end of successive years for each accident year. (5) This line shows the most current estimate of losses assumed by reinsurers for each accident year. (6) These lines show how each accident year's incurred claims increased or decreased as of the end of successive years. This annual re-estimation results from new information received on known claims, re-evaluation of existing information on known claims, as well as emergence of new claims not previously known. (7) This line compares the latest re-estimated incurred claims amount to the amount originally established (line 3) and shows whether this latest estimate of claims cost is greater or less than originally thought. As data for individual accident years mature, the correlation between original estimates and re-estimated amounts is commonly used to evaluate the accuracy of incurred claims currently recognized in less mature accident years. The columns of the table show data for successive accident years.

	Fiscal and Policy Years ended June 30									
	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
<i>(In Thousands)</i>										
1) Premiums, investment, and other revenues										
Earned	\$ 282,668	\$ 285,553	\$ 295,559	\$ 312,476	\$ 329,296	\$ 373,698	\$ 388,179	\$ 417,673	\$ 432,220	\$ 501,170
Ceded	11,552	27,097	67,357	90,070	85,859	74,201	75,298	76,656	51,962	56,738
Net earned	271,116	258,456	228,202	222,406	243,437	299,497	312,881	341,017	380,258	444,440
2) Unallocated expenses	15,054	15,651	15,647	15,349	12,117	14,376	14,564	16,754	16,531	21,195
3) Estimated incurred claims and allocated claims adjustment expense, end of accident year:										
Incurred	255,966	269,942	293,681	318,791	333,067	351,082	334,802	388,645	431,544	450,592
Ceded	11,552	27,097	67,357	90,070	85,859	74,201	75,298	76,656	51,962	56,738
Net incurred	244,414	242,845	226,324	228,721	247,208	276,881	259,504	311,989	379,582	393,862
4) Paid (cumulative) claims and allocated claims adjustment expense as of:										
End of accident year	255,966	213,161	174,540	177,598	198,058	236,905	217,771	262,116	327,451	343,939
One year later	240,631	241,156	225,963	228,783	235,214	271,547	254,001	310,090	374,269	-
Two years later	240,732	241,272	229,191	230,653	235,719	272,155	254,852	310,047	-	-
Three years later	240,752	241,272	229,052	230,283	235,341	272,355	254,887	-	-	-
Four years later	240,771	241,272	228,912	230,283	235,341	272,355	-	-	-	-
Five years later	240,771	241,272	228,912	230,283	235,341	-	-	-	-	-
Six years later	240,771	241,272	228,912	230,283	-	-	-	-	-	-
Seven years later	240,771	241,272	228,912	-	-	-	-	-	-	-
Eight years later	240,771	241,272	-	-	-	-	-	-	-	-
Nine years later	240,771	-	-	-	-	-	-	-	-	-
5) Re-estimated ceded claims and expenses	11,552	27,097	67,357	90,070	85,859	74,201	75,298	76,656	51,962	-
6) Re-estimated net incurred claims and allocated claims adjustment expense:										
End of accident year	244,414	242,845	226,324	228,721	247,208	276,881	259,504	311,989	379,582	393,862
One year later	241,731	241,674	227,191	230,636	235,542	272,137	256,492	319,539	375,350	-
Two years later	240,964	241,674	228,512	229,216	234,523	272,337	255,440	319,306	-	-
Three years later	240,964	241,497	231,224	229,046	234,523	272,757	255,355	-	-	-
Four years later	240,810	241,497	231,224	229,046	234,523	272,757	-	-	-	-
Five years later	240,810	241,497	231,224	229,046	234,523	-	-	-	-	-
Six years later	240,810	241,497	231,224	229,046	-	-	-	-	-	-
Seven years later	240,810	241,497	231,224	-	-	-	-	-	-	-
Eight years later	240,810	241,497	-	-	-	-	-	-	-	-
Nine years later	240,810	-	-	-	-	-	-	-	-	-
7) Increase (decrease) in estimated net incurred claims and allocated claims adjustment expense from end of accident year	(3,604)	(1,348)	4,900	325	(12,685)	(4,124)	(4,149)	7,317	(4,232)	-

Note: The above financial data is summarized for individual contract periods. Subsequent premium and related expense adjustments and reserve developments are recorded in the year incurred for fiscal year financial reporting but are included in the applicable contract year for purposes of the above schedule. Accordingly, components of change in net assets as determined on a contract-year basis will differ from that included in PEIA's fiscal year financial statements.



# Statistical Section

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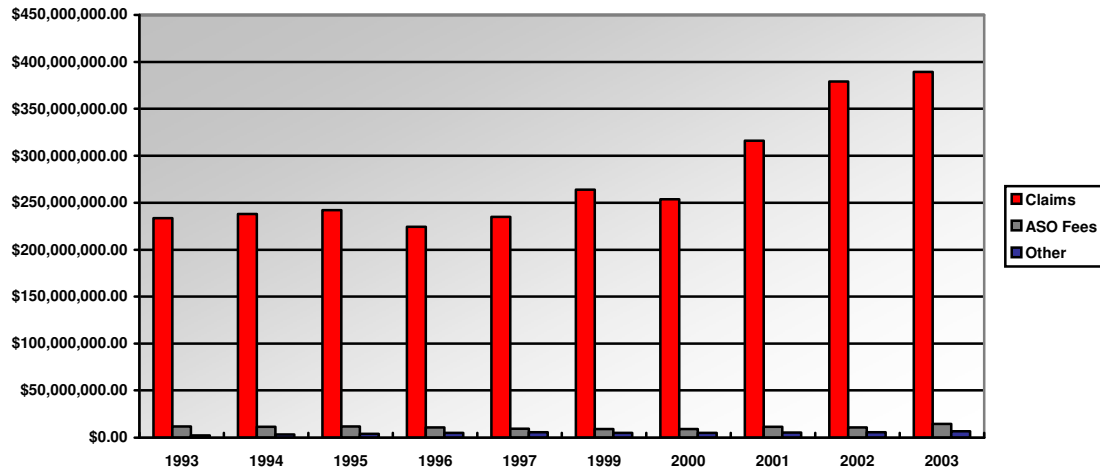


The West Virginia Public Employees Insurance Agency received the Innovation Award from the Council of State Governments for its Multi-State Pharmacy Benefit Management Service known as RxIS. RxIS is a state partnership program that aggregates drug purchasing powers for a single pharmacy benefit manager to lower the unit costs for services provided and allows states in the partnership group to enter into a relationship to increase their negotiating power when seeking prescription drug services.

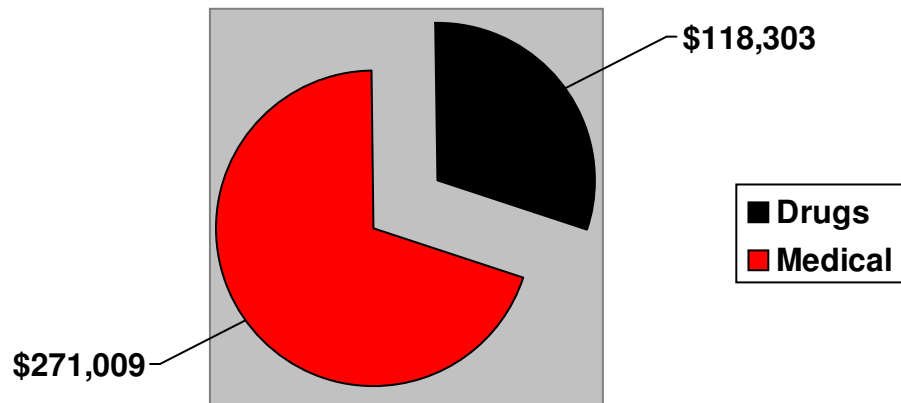


Table 1

## Operating Expenses



### Fiscal Year 2003 Claim Expenses (in thousands)



Source: Financial Statements/Internal Claims Data

Table 2  
**Comparative Statement of Net Assets**  
*Year Ended June 30*

<b>Assets</b>	<b>2003</b>	<b>2002</b>	<b>2001</b>	<b>2000</b>
<b>Current Assets</b>				
Cash and cash equivalents	\$119,019,129	\$91,169,031	\$110,799,153	\$111,969,360
Accounts receivable:				
Due from State of West Virginia	3,705,041	3,936,444	1,331,225	1,665,317
Other, net of allowance for doubtful accounts	21,982,078	15,573,188	11,024,741	7,896,748
<i>Total Current Assets</i>	144,706,248	110,678,663	123,155,119	121,531,425
<b>Non-current Assets</b>				
Furniture and equipment, net of accumulated depreciation	114,789	160,731	221,531	281,346
Restricted cash-premium stabilization	1,350,738	1,698,206	3,607,558	2,025,790
<i>Total Assets</i>	146,171,775	112,537,600	126,984,208	95,037,872
<b>Liabilities</b>				
Claims payable	60,954,556	62,392,297	52,371,174	41,966,795
Premium deficiency reserve	---	---	7,242,000	---
Accounts payable	5,658,850	4,482,151	8,885,733	2,757,534
Deferred Revenue	2,212,693	2,583,614	---	---
Other accrued liabilities	1,174,215	840,632	714,207	585,122
<i>Total Current Liabilities</i>	70,000,314	70,298,694	69,213,114	45,309,451
<b>Net Assets</b>				
Invested in capital assets, net of related debt	114,789	160,731	221,531	281,346
Unrestricted	76,056,672	42,078,175	57,549,563	49,447,075
<i>Total Net Assets</i>	\$76,171,461	\$42,238,906	\$57,771,094	\$49,728,421

*Source: Financial Statements*

## 2003 Comprehensive Annual Financial Report

1999	1998	1997	1996	1995	1994
\$109,959,918	\$116,867,509	\$120,726,616	\$114,577,047	\$108,786,567	\$108,827,481
6,375,786	5,909,807	10,986,255	7,165,849	---	---
7,069,711	6,713,069	13,457,896	8,999,706	15,952,010	10,994,939
123,405,415	129,490,385	145,170,767	130,742,602	124,738,577	119,822,420
295,313	208,452	72,283	63,882	80,999	92,790
---	976,343	924,669	875,785	828,019	784,694
47,567,105	47,424,222	69,484,812	81,865,987	67,826,081	77,878,825
40,605,000	49,890,000	52,703,000	52,934,000	31,411,000	39,463,000
---	2,560,000	13,900,000	---	---	---
878,539	10,767,903	11,640,746	2,221,767	1,578,210	2,237,912
---	---	---	---	---	---
901,001	196,395	127,579	115,054	499,054	145,972
42,384,540	63,414,298	78,371,325	55,270,821	33,488,264	41,846,884
295,313	208,452	72,283	63,882	80,999	92,790
4,887,252	(16,198,528)	(8,958,796)	26,531,284	34,256,818	35,939,151
\$5,182,565	(\$15,990,076)	(\$8,886,513)	\$26,595,166	\$34,337,817	\$36,031,941

Table 3

## Comparative Statements of Revenues, Expenses and Changes in Net Assets

*Year Ended June 30*

	2003	2002	2001	2000
<b>Operating Revenues</b>				
Premiums	\$494,803,110	\$418,663,654	\$396,494,659	\$380,081,007
Less:				
Payments to managed care organizations	(50,336,032)	(46,818,034)	(71,609,138)	(70,757,209)
Life reinsurance premiums	(6,394,214)	(5,144,232)	(5,047,339)	(4,540,875)
Net premium revenue	438,072,864	366,701,388	319,838,182	304,782,923
Administrative fees, net of refunds	4,766,910	4,656,388	4,612,838	3,952,384
<i>Net operating revenues</i>	442,839,774	371,357,776	324,451,020	308,735,307
<b>Operating Expenses</b>				
Claims expense	389,312,256	379,258,215	316,219,643	253,771,160
Administrative service fees	14,444,565	10,917,542	11,471,003	9,316,764
Other operating expenses	6,750,109	5,614,074	5,283,378	5,247,246
<i>Total operating expenses</i>	410,506,930	395,789,831	332,974,024	268,335,170
Operating Income (loss)	32,332,844	(24,432,055)	(8,523,004)	40,400,137
<b>Non-operating Revenues</b>				
Investment income, net of fees	1,599,711	3,099,867	6,565,677	3,145,719
Supplemental appropriations	---	5,800,000	10,000,000	1,000,000
Other revenue	---	---	---	---
<b>Change in Net Assets</b>	33,932,555	(15,532,188)	8,042,673	44,545,856
Net Assets, Beginning of Year	42,238,906	57,771,094	49,728,421	5,182,565
Net Assets, End of Year	\$76,171,461	\$42,238,906	\$57,771,094	\$49,728,421

*Source: Financial Statements*

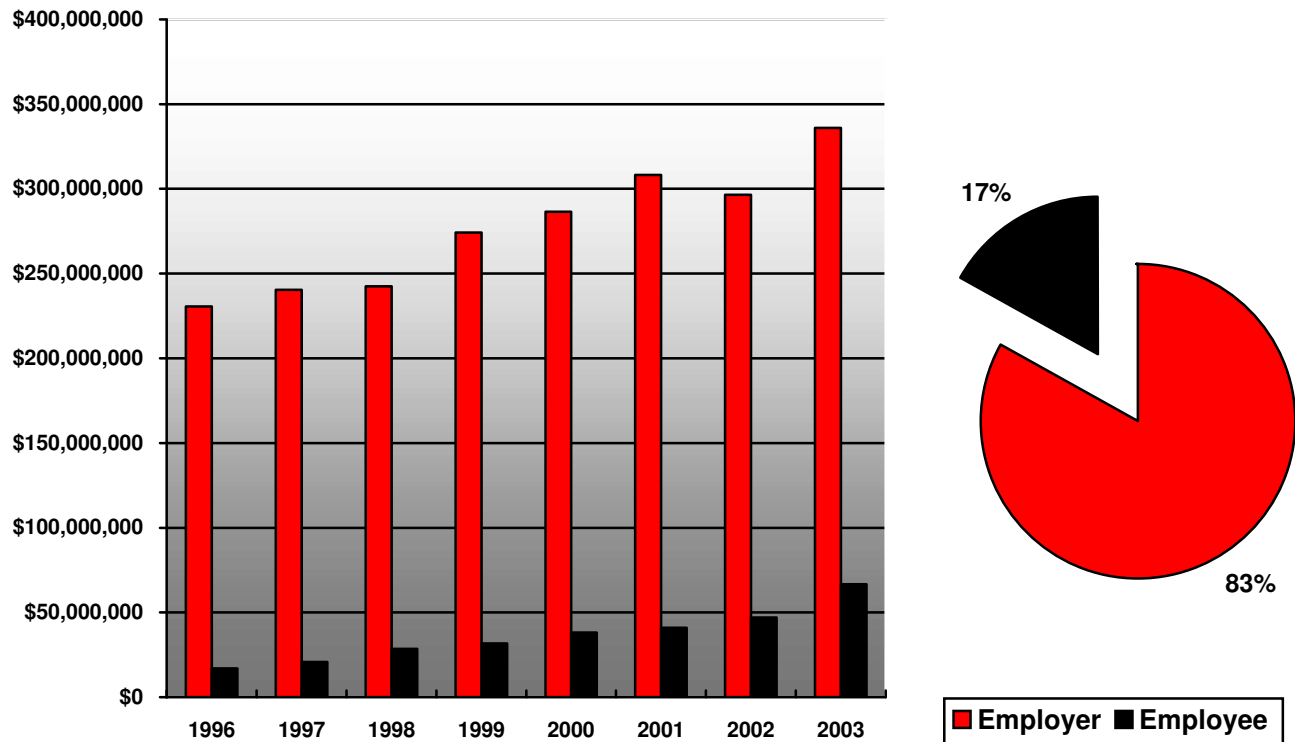
## 2003 Comprehensive Annual Financial Report

1999	1998	1997	1996	1995	1994
\$365,771,569	\$321,955,257	\$309,463,427	\$293,022,029	\$283,193,465	\$280,391,909
(69,713,292)	(81,392,367)	(85,331,092)	(62,874,260)	(18,865,122)	---
(4,488,068)	(4,467,264)	(4,738,484)	(4,482,996)	(12,354,667)	(11,551,867)
291,570,209	236,095,626	219,393,851	225,664,773	251,973,676	268,840,042
3,101,354	3,025,674	2,443,298	2,142,011	2,004,976	1,894,005
294,671,563	239,121,300	221,837,149	227,806,784	253,978,652	270,734,047
263,947,359	238,423,500	234,821,774	224,420,109	241,840,981	237,979,638
9,186,157	8,229,978	9,502,029	10,728,050	11,746,038	11,618,986
5,190,317	3,887,511	5,846,761	4,919,411	3,904,858	3,434,770
278,323,833	250,540,989	250,170,564	240,067,570	257,491,877	253,033,394
16,347,730	(11,419,689)	(28,333,415)	(12,260,786)	(3,513,225)	17,700,653
---	---	---	---	---	---
1,274,911	766,126	569,736	395,135	354,780	382,200
3,550,000	3,550,000	---	---	---	---
---	---	300,000	---	1,464,321	---
21,172,641	(7,103,563)	(27,463,679)	(11,865,651)	(1,694,124)	18,082,853
(15,990,076)	(8,886,513)	18,577,166	38,460,817	36,031,941	17,949,088
\$5,182,565	(\$15,990,076)	(\$8,886,513)	\$26,595,166	\$34,337,817	\$36,031,941

*Note: Prior period adjustments were made in fiscal years 1996 and 1997 due to the correction of an error and implementation of GASB 30. As a result, retained earnings balances do not carry forward in the above table for those years.*



Table 4  
**Source of Premium Revenues**  
(State Fund Only)



Source: Actuarial Financial Reports

Table 5

**Enrollment**

The following tables depict PEIA's enrollment for the past seven years. These tables illustrate the growth of the retiree population and the total population, as well as the peak of managed care enrollment in 1997 and the subsequent decline excepting 2003.

	2003	2002	2001	2000	1999	1998	1997	1996
Active Lives	72,120	71,419	70,751	70,533	70,483	71,019	71,705	71,165
Retirees	29,349	28,920	28,480	27,789	27,035	26,004	25,128	24,907
<i>Total Enrollment</i>	101,469	100,339	99,231	98,322	97,518	97,023	96,833	96,072

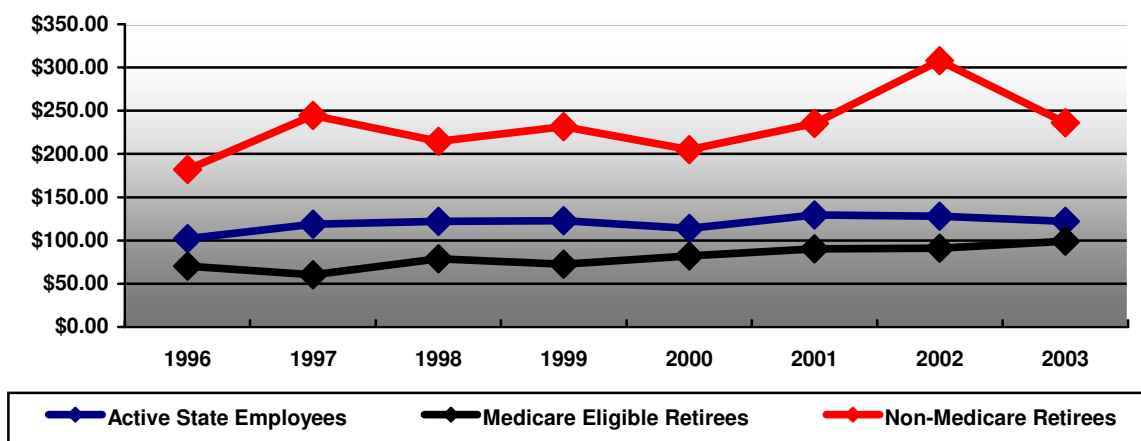
	2003	2002	2001	2000	1999	1998	1997	1996
PPB Enrollment	90,056	90,083	82,664	80,436	79,245	74,216	73,009	77,470
MCO Enrollment	11,413	10,256	16,567	17,886	18,273	22,807	23,824	18,602
<i>Total Enrollment</i>	101,469	100,339	99,231	98,322	97,518	97,023	96,833	96,072

*Source: Information compiled from the Public Employees Insurance Agency's internal data.*

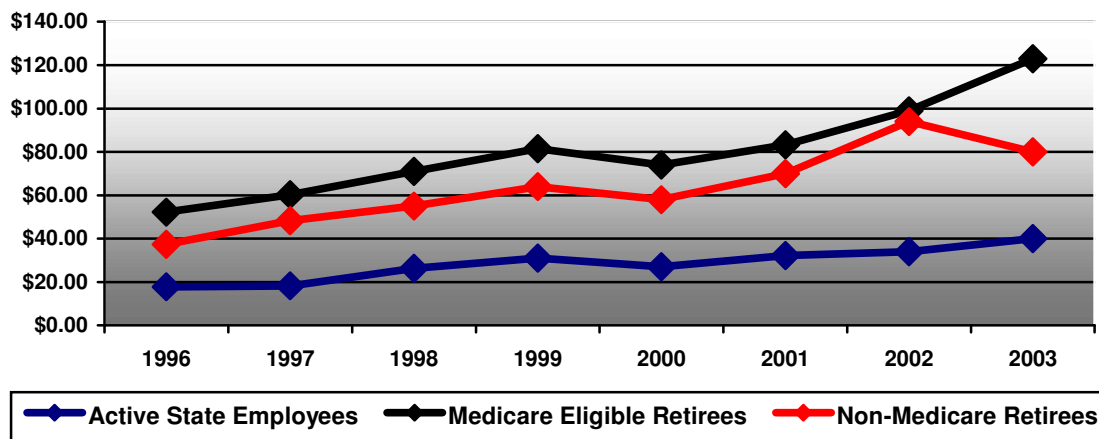
Table 6

# Average Cost Per Member Per Month

## Medical



## Prescription Drugs



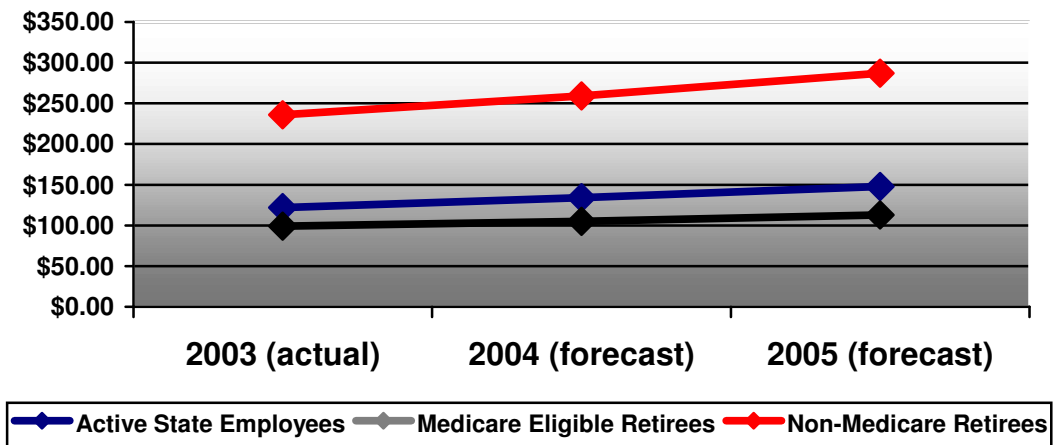
Source: Actuarial Financial Reports

Table 7

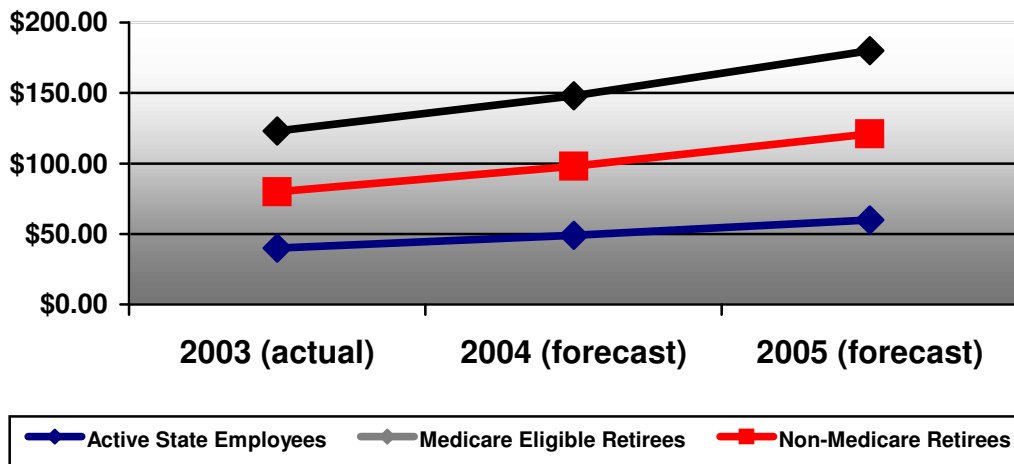
## Trends

(Average Cost Per Member Per Month)

### Medical



### Prescription Drugs



Source: Actuarial Financial and Trend Reports

Table 8

**Top 10 Prescription Drugs**

<b>National</b>	
	<b>Sales (\$ Billions)</b>
LIPITOR	6.5
ZOCOR	4.2
PREVACID	3.8
PROCRIT	3.3
ZYPREXA	3.1
EPOGEN	3.0
ZOLOFT	2.7
NEXIUM	2.6
CELEBREX	2.5
PRILOSEC	2.5

Source: IMS Health NPA+

<b>PEIA</b>		
	<b>PEIA's Annual Cost (\$ Millions)</b>	<b>% of Total Drug Spend</b>
LIPITOR 10MG	4.7	3.97%
LIPITOR 20MG	4.4	3.72%
PREVACID	3.2	2.70%
NEXIUM	3.1	2.62%
CELEBREX	2.5	2.11%
PLAVIX	2.4	2.02%
PRILOSEC	2.3	1.94%
FOSAMAX	1.9	1.61%
PRAVACHOL	1.7	1.44%
OMEPRAZOLE	1.6	1.35%

Source: PEIA Claims Detail



Table 9

Top 10 Diagnostic Categories by Claims Paid			
Diagnostic Category	Paid Claims (in thousands)	Claims	%/paid
Diseases of Circulatory System	\$38,001	223,198	14.02
Neoplasms	\$28,924	104,845	10.67
Systems signs and ill defined conditions	\$28,847	283,500	10.64
Musculoskeletal & connective tissue disease	\$25,709	236,756	9.49
Diseases of digestive system	\$22,282	82,342	8.22
Diseases of genitourinary system	\$21,022	139,903	7.76
Supplemental factors influencing health status	\$20,847	232,472	7.69
Injury and poisoning	\$20,496	131,158	7.56
Diseases of respiratory system	\$16,581	229,060	6.12
Diseases of nervous system & sense organs	\$12,817	127,611	4.73

*Source: PEIA Monthly Healthcare Management Reports*

Table 10

**Top 25 Participating Agencies**

*(as of June 30, 2003)*

West Virginia University  
Department of Transportation  
Kanawha County Board of Education  
Teachers Retirement Board  
Department of Health and Human Resources  
Public Employees Retirement Board  
Berkeley County Board of Education  
Wood County Board of Education  
Raleigh County Board of Education  
Marshall University  
Department of Corrections  
Cabell County Board of Education  
Harrison County Board of Education  
Monongalia County Board of Education  
Mercer County Board of Education  
Marion County Board of education  
Supreme Court/Judicial  
Putnam County Board of Education  
Public Safety  
Fayette County Board of Education  
Wayne County Board of Education  
Division of Natural Resources  
Division of Environmental Protection  
Logan County Board of Education  
Jefferson County Board of Education

*Source: Records of PEIA Premium Accounts*